STATE OF NEW YORK

DIVISION OF TAX APPEALS

In the Matter of the Petition	:	
of	:	
WILLIAM AND DAWN TEMPLE	:	DETERMINATION DTA NO. 818509
for Redetermination of a Deficiency or for Refund of Personal Income Tax under Article 22 of the Tax Law for the Years 1996 and 1997.	:	

Petitioners, William and Dawn Temple, 5 Heidis Path, Ballston Lake, New York 12019, filed a petition for redetermination of a deficiency or for refund of personal income tax under Article 22 of the Tax Law for the years 1996 and 1997.

A hearing was held before Arthur S. Bray, Administrative Law Judge, at the offices of the Division of Tax Appeals, 500 Federal Street, Troy, New York, on May 15, 2002 at 9:15 A.M., with all briefs due by November 8, 2002, which began the six-month period for issuance of this determination. Petitioners appeared by Hiscock & Barclay (Philip J. Vecchio, Esq., of counsel.) The Division of Taxation appeared by Barbara G. Billet, Esq. (Kevin R. Law, Esq., of counsel).

ISSUES

I. Whether it was proper for the Division of Taxation to disallow petitioners' losses from Tesco International because the business was not engaged in for profit within the meaning of IRC § 183.

II. Whether it was proper for the Division of Taxation to deny the casualty losses claimed by petitioners for the years 1996 and 1997.

III. Whether the expenses incurred by petitioners in seeking new employment were deductible.

IV. Whether it was proper for the Division of Taxation to deny certain deductions claimed by petitioners for unreimbursed employee business expenses.

V. Whether petitioners have established that the Division of Taxation improperly imposed penalties.

FINDINGS OF FACT

Background

1. In 1996 and 1997, petitioner William Temple was a senior project manager for Sempra Energy Services Company "Sempra".[1] In this position, he worked a 40- hour week assisting in developing, managing and constructing energy conservation projects. The design of the energy conservation projects was the responsibility of a combination of inside and outside consultants. Mr. Temple critiqued the designs as well as reviewed and approved them. He also visited job sites, prepared estimates of job costs and supervised other employees, subcontractors and outside engineering consultants. In 1996 and 1997, Mr. Temple's wages from Sempra were $66,750.00 and $73,912.38, respectively.

2. Sempra is a Fortune 500 company and engages in business throughout the United States, Europe and Asia. It is Mr. Temple's understanding that he is considered Sempra's best project manager. Sempra has received four national awards based on projects in which Mr. Temple was involved.

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[1] During the years in issue, Sempra was known as CES-Way.

3. In practice, a client would invite Sempra to its facility in order to determine if it could save on the client's utility costs. After entering into certain contracts, Sempra performed an audit to determine where savings could be materialized and the anticipated payback. The recommendations consisted of a mix of energy conservation measures. Mr. Temple was involved in the financial aspects of the projects. He arranged the financial models and put together the budget transmittals and billings for each month. He also wrote the purchase orders, contracts and consultant agreements.

4. Petitioner Dawn Temple has been a registered nurse since 1994. During the years in issue, she worked at Saint Clare's Hospital in Schenectady, New York. In this position, she prepared people for surgery and took care of them after surgery. She also worked in the orthopedic and hospice units. During the years 1996 and 1997, Mrs. Temple's wages from Saint Clare's Hospital were $29,265.43 and $32,688.55, respectively.

Income Tax Returns

5. On their joint New York State Resident Income Tax Return for the year 1996, petitioners reported a business loss of $19,192.99 arising from a firm named Tesco International[2] ("Tesco"). Tesco was an energy service company which was owned and operated by Mr. Temple. Tesco reported that it had no receipts. The reported expenses were as follows:

Expense	Amount
Advertising	$279.00
Car and truck expenses	3,195.92
Insurance	816.00

[2] TESCO stands for Temple Energy Service Company.

Expense	Amount
Legal and professional services	75.00
Office expense	8,623.87
Rent or lease of vehicle	6,203.00
Total	$19,192.99[3]

6. According to petitioners' return, Mr. Temple drove a leased vehicle 17,000 miles for business and 100 miles for commuting.

7. Petitioners reported that they had itemized deductions of $84,362.29. This amount included Mrs. Temple's unreimbursed employee expenses of $7,167.87[4] and job search expenses of $759.15. It also included Mr. Temple's unreimbursed employee expenses of $880.59 and job search expenses of $1,533.74.

8. Petitioners' return stated that they had a casualty loss of $63,908.02 arising from flood damage to their personal residence. According to the return, the property had a cost basis of $125,000.00 and, before the casualty, had a fair market value of $175,00.00. They also reported that, as a result of the casualty, the fair market value of the property declined from $175,000.00 to $102,651.00.

9. On their New York State Resident Income Tax Return for 1997, petitioners reported a business loss from Tesco in the amount of $37,450.49. As was the case with the prior year's return, Tesco had no receipts. The reported expenses were as follows:

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[3] It appears that petitioners' made a small arithmetic error in totaling the amount of the loss. The reported loss totals $19,172.79.

[4] This expense was claimed for the cost of the uniforms worn by Mrs. Temple, the cost of cleaning the uniforms and the related mileage.

Expense	Amount
Advertising	$152.10
Car and truck expenses	4,532.43
Insurance	928.00
Interest - other	75.00
Office expense	21,216.44
Rent - vehicles	10,436.47
Taxes and licenses	110.00
Total	$37,450.49

10. According to the return, Mr. Temple drove a leased vehicle 21,800 miles on business and 150 miles commuting.

11. Petitioners claimed itemized deductions in the amount of $56,728.19. This amount included Mrs. Temple's unreimbursed employee expenses of $6,177.72, Mr. Temple's unreimbursed employee expenses of $1,416.68 and unknown expenses of $1,243.18.

12. Petitioners reported a casualty loss of $34,873.41 from a flood on November 17, 1997 which caused damage to their personal residence and to their furniture, equipment and materials. According to Federal form 4684, the residence had a cost or other basis of $125,000.00 and a fair market value before the casualty of $150,000.00. The schedule reported that, after the casualty, the residence had a fair market value of $125,185.63. Petitioners further reported that their furniture, equipment and materials had a cost or other basis of $17,224.86 and that this was also the value before the casualty. According to the return, these items had no value after the casualty.

Commencement of the Audit

13. After reviewing the returns, the Division of Taxation ("Division") determined that an audit should be conducted. Initially, the Division experienced difficulty in scheduling an audit appointment because of repeated requests by petitioners for postponements and rescheduling. The difficulty in scheduling an appointment prompted the Division to issue an assessment disallowing petitioners' business expenses. Thereafter, petitioners scheduled an audit appointment.

14. An audit appointment took place on August 12, 1999. During the meeting, Mr. Temple explained that he, through Tesco International, was trying to devise a better flushing system that would conserve water. Mr. Temple stated that most of his evenings were consumed in his garage designing items that have to do with flushing. According to Mr. Temple, he leased a Lexus automobile for his business and deducted, on his schedule C, the cost of the lease payments, repairs and auto insurance. He further explained that he drove the Lexus to construction sites to pick up used water closets so that he could examine them.

Audit of 1996

15. The Division analyzed whether Tesco was being carried on in a businesslike manner. In the process, it found that although the business was started in 1994, there were no receipts in 1994, 1995, 1996 or 1997. As a result, it concluded that none of the business expenses for 1996 should be allowed because it did not consider the business to be carried on for profit. Even if it had determined that the business was operated for profit, certain expenses would have been

disallowed because they were not supported by documentation or receipts or they were deemed personal in nature.[5]

16. Upon reviewing the deduction for the casualty loss, the Division noted that an appraisal was not performed and that the amounts of $175,000.00 and $102,651.00 were estimates. Further, there was no record to show that the items of personal property existed in the house, to show that they were damaged, to show what their value was at the time of the loss or to show what petitioners paid for them. The Division disallowed the casualty loss in its entirety because (1) petitioners did not present a competent appraisal of the fair market value of the property before and after the casualty loss; (2) a letter from an insurance company indicated that the damage was to the basement only; (3) the loss must be based on fair market value and not cost; and, (4) no documentation was presented to prove that items existed or were destroyed.

17. In support of their claim for unreimbursed employee expenses for 1996, Mr. Temple offered the Division a list of expenses for clothing that Mrs. Temple purchased for her job, the mileage she traveled to obtain the clothing and the cost of the clothing. The cost of detergents to clean the clothing was also included on the list. Upon reviewing the list, the Division disallowed items that were purchased from stores such as Walmarts, J.C. Penney Co. Inc. ("J.C. Penney") and Barbara Moss because there were no detailed receipts showing what was purchased at the store which would have enabled the Division to identify the item as part of Mrs. Temple's

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[5] In essence, the Division would have allowed 25 percent of the car expenses, insurance and cost of the leased vehicle for a total of $10,327.61. Three-quarters of the car expenses, insurance expenses and rental expenses would have been disallowed because these items related to lease payments on the Lexus automobile and were regarded as nondeductible personal expenses. The Division believed that the automobile was used primarily for personal and not business reasons. The amount purporting to be advertising was a newspaper subscription that the Division concluded was a nondeductible personal expense. Legal and professional expenses and office expenses would have been disallowed because, among other things, they were regarded as nondeductible personal expenses.

uniform or something specific to the nursing uniform. The Division allowed deductions for purchases from Uniform Village and Sherons because these were shops which sell uniforms. The Division did not allow a deduction for the mileage claimed to purchase an article of clothing and return regardless of whether the cost of the item was deductible because the Division did not think that the cost of the mileage to buy a deductible item is deductible. Further, petitioners did not maintain a contemporaneous log of mileage.

18. The Division examined Mr. Temple's unreimbursed employee expenses of $880.59 and found that the expenses claimed were for safety equipment consisting of safety glasses and multiple pairs of safety boots, that is, those with steel toes and steel shanks. Mr. Temple also claimed a deduction for the mileage he incurred to purchase the items. The Division disallowed a deduction for these items because the items purchased were regarded as personal and because it did not see any receipts for the purchases. In reaching this conclusion, the Division noted that the safety boots were purchased from an establishment known as Norse House, which was a ski shop in Vermont. The Division also found that the expense for the safety glasses was incurred at Sunglass Hut. Even if it had seen the receipts and allowed the expense, the Division would not have allowed the mileage to purchase the items.

19. Mr. Temple's job search expenses were based upon the mileage he allegedly incurred looking for employment. These expenses were disallowed because the travel claimed was regarded as primarily for personal reasons and because there was a lack of adequate records to prove the expense. Further, no documentation was provided by petitioners to establish that Mr. Temple was actually searching for a job. Similarly, Mrs. Temple's job search expenses were

disallowed because there was no mileage log or documentation to show that she was actually seeking a job or interviewing on these trips.

20. The Division allowed a deduction for the cost of having Mrs. Temple's uniforms professionally cleaned. However, it disallowed a deduction for the mileage to bring an article of clothing to the cleaners to have the item cleaned. It also disallowed the deductions claimed for detergent, Clorox and whiteners under the assumption that if Mrs. Temple was bringing the items to the cleaners, she would not be washing them at home. In addition, it felt that personal use of the detergents might be involved.

21. Although the deduction for some of Mr. and Mrs. Temple's unreimbursed employee expenses were regarded as permissible, they were totally disallowed because of the two-percent limitation on miscellaneous itemized deductions.

Audit of 1997

22. For the year 1997, the Division concluded that Tesco was not carried on in a business-like manner and that it was not operated for profit. Therefore, it disallowed the entire loss as a hobby loss. Nevertheless, as it had done for the previous year, the Division reviewed petitioners' business expenses in the event it was concluded that Mr. Temple was operating Tesco for profit.[6]

23. Mr. Temple's unreimbursed job expenses of $1,416.68 for 1997 were allegedly incurred for the acquisition of safety glasses, safety boots and safety gloves. They were also incurred for the repair of safety gloves. The associated mileage was also deducted. The Division disallowed the entire expense because there was a lack of receipts to prove the

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[6] If the Division had determined that Tesco was operated for profit, it would have allowed a loss of $15,395.57. This amount is based upon 25 percent of the car, insurance, rental, tax and license expenses. It also includes $11,868.76 of the office expense.

expenses. In addition, the purported business mileage was disallowed because the mileage was considered primarily personal. Mrs. Temple's unreimbursed employee expense of $6,177.72 was premised upon the cost of the nursing attire, the cost of cleaning the nursing uniforms and the associated mileage incurred to purchase and clean the uniforms. The Division allowed a deduction for the dry-cleaning costs and the expenses incurred at the uniform shops. The remaining expenses, including mileage, cost of detergents which were used at petitioners' home and expenses incurred at stores which did not specialize in uniforms such as Walmarts and J.C. Penney were disallowed. After totaling all of Mr. Temple's and Mrs. Temple's unreimbursed expenses, an additional amount of $1,243.18 remained. Petitioners did not provide any explanation of what this amount was or what it corresponded to. Since there were no receipts to support the deduction, it was labeled unknown and disallowed.

24. With respect to the casualty loss, Mr. Temple advised the Division that he determined the $150,000.00 value himself based on the value of properties in the area. Mr. Temple also explained that historical cost was used to value the items of personal property. The Division disallowed the casualty losses in full because there was no appraisal before or after the flood to determine the fair market value or petitioners' actual loss. In addition, no receipts or other documentation were presented to establish the amount of the loss. The Division did not question that there was water damage to the house.

25. On the basis of its audit, the Division issued a Notice of Deficiency to petitioners, dated November 26, 1999, which asserted a deficiency of personal income tax, interest and penalty for negligence as follows:

Period	Tax	Interest	Penalty	Balance Due
1996	$5,802.44	$1,214.60	$897.42	$7,914.46
1997	$5,128.94	$599.15	$556.02	$6,284.11
Total	$10,931.38	$1,813.75	$1,453.44	$14,198.57

26. In 1994, Mr. Temple decided to pursue a business which involved modifying the Sloan flush valve, which is standard equipment, in order to regulate how long a flushometer is open and closed. Mr. Temple anticipated that his product would save water each time a water closet or urinal was used which would, in turn, save money on water and sewer bills. Mr. Temple expected to not only acquire a patent but also to operate a business. According to Mr. Temple, he expected to profit from the sale of the modifications and from the installation of the components. Mr. Temple saw a potential for excellent savings and anticipated that the product would be purchased by State and Federal governments and institutions such as hospitals, schools and large office buildings. Mr. Temple ran some financial models with regard to the savings on institutions and it showed a payback period to the owner of roughly three and three-quarter years. Mr. Temple asserted that he would be in a position to guarantee his customers a certain level of savings and if these savings were not achieved, he would write them a check for the difference between what was guaranteed and what actually materialized in savings.

27. Mr. Temple visited construction sites in order to obtain the porcelain parts used in a toilet or urinal. For a particular piece of china and a relief valve, Mr. Temple would conduct tests using various pressures to find the least amount of water that could pass the flush test - 80 sheets of toilet paper. Mr. Temple performed all of the testing of his prototypes at his home at 5 Heidis Path in Ballston Lake.

28. Mr. Temple prepared a matrix which selected the type of china, flushometer, Sloan relief valve and modifications which would make it acceptable to pass the flush test. He would then modify the orifice so it would operate at the pressure he established. Thereafter, he would test with other pressures. Testing the various pressures has been an ongoing process.

29. Mr. Temple's matrix deals with 90 percent of the porcelain currently in use. For some porcelain, it is not possible to put in a low consumption device because it will not pass the flush test. For these customers, the porcelain has to be replaced.

30. If Mr. Temple were to make a proposal, he would survey the premises to determine what the water pressures are on each floor, each wing, or at the end of each floor and then determine what the savings would be in dollars and water. Thereafter, a financial model would be developed to determine what the cost would be to implement the water conservation measures. This would be developed into a detailed survey arrangement for the customer to accept or reject. Based on the information gathered throughout the years and the type of flushometer, Mr. Temple would select the appropriate relief valve and diaphragm.

31. There are a number of reasons why the product has not been placed on the market. One reason is product liability. It takes time to develop a reliable product. There is a risk that a water closet could overflow and damage items such as computer equipment, records and building materials. Another reason that the product has not been placed on the market is that there are a number of differences from building to building and from floor to floor. Each floor has a different water pressure and each section of the city may have a different water pressure. Mr. Temple also had to test a number of different scenarios. In a medium-sized hospital there may be 500 water closets in the facility. According to Mr. Temple, one has to go to each wing of

each floor and determine what the water pressure is over a 24-hour period for six months before one could refer back to the engineering matrix to determine what kit should go in what floor and wing of the building. Mr. Temple did not approach potential customers in 1996 or 1997 because he was still in the development stage.

32. There are other companies or individuals that are engaged in performance engineering pertaining to water savings with toilets. However, they are taking a standard approach like Sloan. The other companies do not modify the diaphragm.

33. At the hearing, Mr. Temple explained that he expected that Tesco would be profitable on the basis of a number of studies he had done in the past. He anticipated that eventually the profits would more than offset the losses and he could retire on the profits from the business. None of these studies were offered into evidence at the hearing.

34. As of the date of the hearing, Mr. Temple stated that he believed that he was ready to approach clients. However, he feels that he needs to find the right client.

35. Mr. Temple has brought other innovations to market and sold them. The expenses for developing the other products were written off on the tax return of a company that Mr. Temple owned. He recouped all of the expenses he incurred in this design.

36. Mr. Temple asserted that the expense for the lumber that was disallowed was used "for the most part " for mockups in connection with Tesco. According to Mr. Temple, it was not related to improving his house or in any way modifying his house or office. Mr. Temple does his design and testing at his residence.

37. At the hearing, Mr. Temple explained that he usually does not follow current events. Rather, he subscribed to a newspaper in order to find out what was going on in the community

regarding demolition and new construction. This enabled him to ascertain if porcelain would be available. Nevertheless, he subscribed to newspapers prior to 1994 when he started Tesco. At that time, the purpose was just to have a newspaper. Mrs. Temple explained that she read the Times Union largely to see the advertisements for nurses. However, prior to becoming a nurse, she read the newspaper.

38. In 1996, Mr. Temple leased a Lexus automobile. In 1997 the lease on the Lexus expired and he leased an Acura. During the years in issue, Mr. Temple drove a Honda Accord, which he owned, for personal use. He also drove a Nissan automobile which he owned. Mr. Temple also owned a 1970 Mustang but he did not drive it. At the hearing, Mr. Temple explained that he used his leased vehicle to drive to job sites to pick up china. He also anticipated using the vehicle to meet potential customers.

39. Mr. Temple drove the Lexus to Sempra and back if there was a reason. On one or two occasions, he may have driven the vehicle in order to have it serviced. The Lexus dealership was near where Mr. Temple's employer was located. Therefore, Mr. Temple would bring the vehicle to the dealership and the dealership would take Mr. Temple to work. At the hearing, Mr. Temple estimated that personal use of the automobile amounted to approximately 200 to 300 miles a year.

40. If Mr. Temple was wearing the correct safety gear such as a hard hat and safety glasses, he would be allowed to enter the demolition site and remove some of the porcelain and flushometers. Sometimes the porcelain would be piled up outside of the building and he would examine the material at the demolition site. Neither the china nor the flushometers had significant scrap value.

41. The only time Mr. Temple used items such as safety glasses, safety boots and safety gloves was in connection with his employment at Sempra Energy Services. Mr. Temple felt that he needed work clothing because he was required to visit construction sites to survey the progress of each project. Each of these projects came under the rules and regulations of OSHA[7] which required, among other things, safety glasses and safety boots. Mr. Temple had to ensure that subordinates were compliant with OSHA. During the years in issue, Mr. Temple visited construction sites once or twice a week. Mr. Temple asserts that the boots he purchased in 1996 were not ski apparel. Further, Sunglass Hut did not sell safety glasses. However, Mr. Temple had to buy the frame from Sunglass Hut for the safety lenses which were provided by Troy Eye Associates. Mr. Temple wore the glasses while he was driving and while he was on the job.

42. Petitioners' home is located adjacent to a farm field which slopes on two corners toward petitioners' property. Whenever the ground is frozen and there is a heavy rainfall the debris from the field will wash toward the back of petitioners' property and flood the street in front of petitioners' home. On January 19, 1996, the street was flooded to a level where the water was above the roofs of cars and petitioners had flooding in the basement and first floor of their home. As a result, petitioners had to cope with the mud and chemicals that were used on the farm such as insecticides and fertilizers. Although flooding has occurred on more than one occasion in the basement, this was the only time it occurred on the first floor. A number of homes in petitioners' housing development suffered water damage.

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[7] OSHA stands for the Occupational Health and Safety Administration.

43. Petitioners submitted a list of the items of personal property which were allegedly lost in the respective floods. Adjacent to each item they recorded the cost of the item. Petitioners did not provide evidence concerning the items' fair market value.

44. The flooding caused the insulation between the walls to become wet which, in turn, caused mold to grow between the walls. Further, the floors warped and the carpets became stained. According to the receipts offered by petitioners at the hearing, Mr. Temple purchased materials at a cost of $17,929.73 in order to restore his home because of the damage caused by the flood in 1996.

45. Petitioners submitted an appraisal, dated April 10, 2002, to substantiate a portion of the casualty losses which occurred on January 19, 1996 and November 7, 1997, when another flood occurred. The appraisal states that the market value of petitioners' residence prior to the flood on January 19, 1996 was $135,000.00 and after the flood was $61,250.00. The appraisal values the residence at $135,000.00 immediately prior to the November 7, 1997 flood and $76,250.00 following the flood. In his appraisal report, the appraiser viewed the flooding as one of external obsolescence because the cause of the problem was external to the subject property and petitioners did not have direct control of the problem. For each of the years in issue, the appraiser reduced the market value of the residence by a "cost to cure." For 1996, the cost to cure was $40,000.00 and for 1997 the cost to cure was $25,000.00. In each instance, the appraisal report states "[a] review of past and current costs to cure the flood/water damage to the lower finished basement area has a range from $18,000.00 to $40,000.00 per year." There is no data or information provided to support the particular amounts ascribed to the "cost to cure" in

either year.[8] Petitioners' appraiser viewed the flooding as "a recurring problem on an annual basis. . . . " In determining the valuation for 1996, the appraiser reduced the value of the property by 20 percent or $27,000.00 apparently on the basis of the anticipated market reaction to the flooding problem. The appraiser did not factor in the $27,000.00 reduction when estimating the value of the residence immediately before the flood of November 7, 1997. However, he reduced the market value of the residence by the same $27,000.00 after the flood of November 1997. The appraiser also reduced the value of the property by 5 percent, or $6,750.00, during each of the years in issue because of a stigma. The appraiser believed that this adjustment was warranted because, even if it were possible to remedy the flooding problem, a stigma would be attached to the property and the area affected by the flooding.

46. The figure of $175,000.00 for the value of his home on the casualty loss form for 1996 was based on an estimate from Mr. Temple's insurance agent who had come to his property. Mr. Temple prepared his own return and does not believe that the structure was restored to the $175,000.00 value because he did not replace paneling in a particular room and the tiles in the bathroom were replaced with a lower grade of tile.

47. Mr. Temple incurred job hunting expenses in 1996 because he was looking for work in the same profession with another firm. He did not write down the names of the employers that he visited because he was concerned that others might see it.

48. Mr. Temple converted his garage into his office. During the years in issue, Mr. Temple's office contained a desk, computer, drafting board, several bookcases containing engineering books, filing cabinets, records, files and electronic equipment that he used for

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[8] The appraisal report directs the reader's attention to the homeowner's records for the actual cost to cure.

testing. Personal records, such as insurance, were not kept in the office. Mr. Temple used a computer located in a second floor bedroom for preparing resumes and cover letters. When Mr. Temple was working at home on Sempra business, he usually worked on his dining room table. Other than the drafting board, the office did not have a table large enough to spread out his papers.

49. The hospital where Mrs. Temple was employed had a dress code which described what the uniform may consist of. If a nurse appeared for duty in attire that did not comply with the code, the nurse could be sent home to change. Having clothes become soiled while at work was common. Since the hospital wanted nurses to be neat and clean, it was anticipated that a nurse would have the uniforms cleaned in some fashion when he or she went home.

50. Mrs. Temple was employed in the "med-surg" unit of Saint Claire's Hospital. Her position caused her to come into contact with bodily fluids. Further, Mrs. Temple's unit also took care of patients who were HIV positive. In addition, the floor where Mrs. Temple worked also had isolation rooms for patients with tuberculosis.

51. Mrs. Temple worked the 11:00 P.M. to 7:00 A.M. shift. In the nighttime the hospital was cooler and Mrs. Temple looked for a sweater to wear. It started getting warmer about 6:00 A.M.

52. Mrs. Temple washed her nursing uniforms separately from her family's clothes because of what she is exposed to. She also washed them separately because she used a lot of Clorox and detergent. The excessive exposure to bleaches eventually wore away the clothes. Mrs. Temple maintained a separate supply of detergents for the clothes she wore for her job and the clothes she and Mr. Temple wore other than for work.

53. Mrs. Temple used several different vendors for uniforms because she liked to add variety and style to her uniform. She probably had more uniforms than other clothing because she worked a lot and changed her uniform every day. As far as Mrs. Temple was concerned, once clothing was worn on a nursing duty shift, it was not appropriate for personal use. She did not wear her work uniform after work hours. Similarly, she would not go to work on a shift with an outfit she had been wearing all day around town. The least expensive place Mrs. Temple could purchase a uniform, besides a uniform store, was a department store such as Walmart's, J. C. Penney or Sears. A nurse at Saint Claire's could buy white street clothes at Barbara Moss or J.C. Penney's and assemble them in such a way that they would meet the hospital's uniform code. However, the items which Mrs. Temple purchased from stores such as Walmarts, Bradlee's, Talbot's, Barbara Moss or J.C. Penney's could have been worn on the street as regular clothes.

54. When Mrs. Temple purchased clothing she was interested in functionality. It had to have a certain look about it. It also had to have a certain number of pockets so she could perform her job. Pockets were important because she carried a stethoscope, bandages, tape, scissors, pens, and other items. Saint Claire's did not provide an allowance for uniforms for the registered nurses.

55. Mrs. Temple's deduction for job search expenses was premised, in part, upon the expense she incurred in mileage looking for new employment. She also deducted the cost of a subscription to a newspaper as a job search expense. During the years in issue, Mrs. Temple interviewed with different hospitals in the area and at some job fairs. Mrs. Temple was interested in ascertaining if there was a position that she would be interested in as a nurse.

CONCLUSIONS OF LAW

A. The issue presented in this case is whether petitioners have substantiated the deductibility of a series of expenses. In essence, this raises two questions: whether petitioners are entitled to deduct the expense as a matter of law and the amount of the deduction which is to be allowed. The Tax Law of the State of New York imposes upon petitioners the burden of refuting the Division's disallowance of the deductions and of establishing their entitlement to the expenses claimed (Tax Law § 689[e]; ***see***, ***Matter of Schneier***, Tax Appeals Tribunal, November 9, 1989). The starting point for determining New York personal income tax liability is a taxpayer's Federal adjusted gross income (Tax Law § 612[a]; 20 NYCRR 112.1). Since the New York State personal income tax law is patterned after the Federal income tax laws, Federal law is determinative of the substantive questions presented in this matter (***see, Hunt v. State Tax Commn.,*** 65 NY2d 13, 16-17, 489 NYS2d 451, 453; ***Matter of Rizzo***, Tax Appeals Tribunal, June 3, 1993, ***confirmed Rizzo v. Tax Appeals Tribunal***, 210 AD2d 748, 621 NYS2d 115).

B. The first issue to be addressed is whether Tesco was engaged in for profit within the meaning of Internal Revenue Code § 183, which provides, generally, that where an activity is "not engaged in for profit," deductions attributable to such activity are allowable only to the extent of income from such activity. At issue in this matter is whether, during 1996 and 1997, Mr. Temple's activities with Tesco were engaged in for profit within the meaning of that section. Resolution of this issue turns on whether Mr. Temple had an actual and honest objective of making a profit from his purported business activity (***see, Dreicer v. Commissioner***, 78 TC 642, 645, ***affd*** 702 F2d 1205). Such an objective is properly determined upon review of the

surrounding facts and circumstances and in consideration of the nine factors set forth in Treas Reg § 1.183-2(b) (***See, Hoag v. Commissioner***, 66 TCM 326, 328).

C. The "nine factors" listed in the regulations to help determine whether a taxpayer has engaged in an activity for profit are as follows: (1) the manner in which the taxpayer carries on the activity, (2) the expertise of the taxpayer or his advisors, (3) the time and effort expended by the taxpayer in carrying on the activity, (4) expectation that assets used in the activity may appreciate in value, (5) the success of the taxpayer in carrying on other similar or dissimilar activities, (6) the taxpayer's history of income or losses with respect to the activity, (7) the amount of occasional profits, if any, which are earned, (8) the financial status of the taxpayer, and (9) elements of personal pleasure or recreation (Treas Reg § 1.183-2[b]). The factors listed above are intended as guidelines and are nonexclusive. Accordingly, no single factor or combination of factors is conclusive in indicating a profit objective (***see, Yancy v. Commissioner*** 48 TCM 872, 874).

D. The nine factors as applied to this case are as follows:

(1) Manner of Carrying on the Activity

The question presented is whether Mr. Temple was operating Tesco in a manner which demonstrates a profit motive (***see***, Treas Reg 1.183-2[b][1]). A profit motive may be indicated by a taxpayer's changing operating methods, adopting new techniques or abandoning unprofitable methods in a manner consistent with an intent to improve profitability (***id***).

Here, the Division has correctly noted that the manner in which Mr. Temple operated Tesco casts doubt upon whether he had a true profit motive. Petitioners deducted all of the costs of leasing and maintaining a Lexus automobile in 1996 and an Acura automobile in 1997. If one

were to accept Mr. Temple's explanation, he leased a Lexus automobile, an acknowledged luxury car, and an Acura automobile in order to pick up discarded toilet bowls and urinals at construction sites. According to the tax returns, he traveled 38,800 miles over a two-year period in this endeavor and, during the same period of time, he reported that he only drove the Lexus and Acura a total of 250 miles for personal use.

Tesco claimed an advertising expense based on acquiring a local newspaper, the Times Union. Both Mr. and Mrs. Temple stated that they read the newspaper prior to 1994. However, for some reason, after starting Tesco, Mr. Temple was only interested in the newspaper because it listed construction or demolition sites. It is also noteworthy that despite the fact that he was not ready to market his product during the years in issue, Mr. Temple stated, at one juncture, that he leased the automobiles to meet potential customers.

It is concluded that the very substantial mileage coupled with the use of luxury automobiles at a time when there was not any revenue is not indicative of one who was attempting to improve profitability. This factor does not support petitioners' position.

(2) Expertise of Taxpayer or His Advisors

Mr. Temple has established that he has substantial expertise in "performance engineering." Therefore, it is concluded that this factor inures to petitioners' benefit.

(3) Time and Effort Expended in Activity

The record shows that Mr. Temple was a senior project manager for Sempra and that he assisted in developing, managing and constructing energy conservation projects. In this capacity he worked 40 hours a week. Although the record also shows that Mr. Temple made trips to pick up discarded toilets and urinals and tested these items at various pressures, the record does not

reveal how much time Mr. Temple devoted to this project. Since Mr. Temple bears the burden of proof, the lack of evidence lends support for the Division's position.

(4) Expectation that Assets May Appreciate

This factor does not appear to have any bearing on the matter.

(5) Taxpayer's Success in Carrying on Other Activities

At the hearing, Mr. Temple stated that he had brought other products to the market and sold them. Mr. Temple explained that the expenses for developing the previous products where deducted on the tax return of the company that he owned and that he recouped all of the expenses he incurred in the design. Unfortunately, there is no evidence regarding what the previous products were or any detail regarding the prior history of income and expenses. The lack of evidence requires that this factor be regarded as supporting the Division's position.

(6) Taxpayer's History of Income or Loss

A history of substantial losses may indicate that the activity was not engaged in for profit (***see, e.g.***, Treas Reg § 1.183-2[a]; ***Hoerrner v. Commissioner***, 50 TCM 417,430). However, a taxpayer may have a profit objective even when the activity has a history of losses without any profit (***see, Bessenyey v. Commissioner***, 45 TC 261, 274, ***affd*** 379 F2d 252, ***cert denied*** 389 US 931, 19 L Ed 2d 283).

In this case, the enterprise not only did not show a profit in any year, it did not have any revenues. In their brief, petitioners have argued that Mr. Temple's experience includes job costing and financial models. They also argue that Mr. Temple has calculated the prospects of generating a profit and that he testified about his expectations of a profit from Tesco International.

The evidence offered by petitioners on this point was not persuasive. Although Mr. Temple stated that he ran financial models, no documentation on this point was presented. Further, while Mr. Temple explained that he needed to exercise care before bringing his product to the market and that he planned on making a profit on his idea, no timetable was presented as to when this project would come to fruition. It is concluded that petitioners have not sustained their burden of proof on this point.

(8) The Taxpayer's Financial Status

According to the regulations, the fact that the taxpayer does not have substantial income from sources other than the activity in question may suggest that the activity is engaged in for profit. Here, as the Division noted in its brief, petitioners have substantial income from their respective professions. Hence, it is found that this point supports the Division.

(9) Aspects of Personal Pleasure

Petitioners contend that there is no aspect of personal pleasure in developing flush valves for toilets and that this case is distinguishable from typical hobby loss case involving horse breeding or car racing. This position is accepted as a factor in petitioners' favor.

E. Upon reviewing the expenses and the surrounding circumstances it is concluded that Mr. Temple did not have the objective of making a profit. The weight of the evidence supports the conclusion that Tesco was a mechanism for shifting nondeductible personal expenses (such as the cost of driving an automobile or subscribing to a newspaper) to deductible business expenses. In view of the foregoing conclusion, petitioners' argument that the expenditures made by Mr. Temple prior to bringing the product of Tesco International to market may be deducted

each year is academic. The argument that the expenditures of Tesco International were "ordinary and necessary" is also moot.

F. In general, IRC § 165(a) and (c) permit a deduction for a casualty loss. Initially, the Division argues that petitioners are not entitled to a casualty loss because the flooding was a recurring annual problem and not sudden and unexpected.

In my opinion, the Division's interpretation of the facts and the law is unnecessarily constrained. Initially, it is acknowledged that petitioners' appraiser described the flooding as "a recurring problem on an annual basis. . . . " However, the statement from the appraiser must be viewed in context. There is no evidence that there was any flooding prior to 1996 or that there was any reason to anticipate that there would be a flood before 1996. As petitioners pointed out, an analogous situation was presented in ***Heyn v. Commissioner*** (46 TC 302). In ***Heyn***, the taxpayer began erecting a building on the side of a hill containing unstable soil. An earth slide occurred at the construction site resulting in about 200 cubic yards of earth falling at the deepest point of the excavation. The Commissioner argued that this was not a casualty within the meaning of IRC § 165(c)(3) because it should have been anticipated and because it was the fault of the contractor.

To the extent relevant to the issues presented here, the Court concluded that there was a casualty within the meaning of the pertinent section of the Internal Revenue Code. Specifically, the Court noted, among other things, that the physical characteristics of a landslide were plainly associated with a casualty and that it involved the sudden and violent movement of a large mass of earth that was cataclysmic in nature. The fact that it might have been foreseen or prevented by the exercise of due care did not require that the landslide be denied being considered a

casualty. Similarly, in this instance, the flooding of petitioners' home was clearly in the nature of a casualty. Further, the fact that it might have been foreseen does not prevent it from being regarded as a casualty within the meaning of the pertinent section of the Code. Therefore, it is concluded that petitioners suffered a casualty loss within the meaning of the Internal Revenue Code.

G. The next issue presented is determining the amount of the deduction attributable to the casualty. The amount of loss from a casualty is the lesser of the difference in fair market value immediately before and immediately after the casualty or the adjusted basis for determining the loss from the sale or other disposition of the property (Treas Reg § 1.165-7[b][1][i], [ii]). Generally, the fair market value of property before and after the casualty is determined by a competent appraisal (Treas Reg § 1.165- 7[a][2]). Proof consisting of an estimate of the cost of repairs is not evidence of the actual cost of repairs unless the repairs are performed (***see, Lamphere v. Commissioner***, 70 TC 391).

Here, petitioners submitted a list of the items of personal property which were allegedly lost in the respective floods. Adjacent to each item they recorded the cost of the item. Petitioners did not provide evidence concerning the items' fair market value. Under the circumstances, the schedule does not provide any basis to determine the amount of a casualty loss for the items of personal property which were lost. However, on the basis of the receipts submitted at the hearing, petitioners have substantiated a deduction of $17,929.73 based upon what was damaged in the flood of January 19, 1996.

H. In regard to the real property, petitioners submitted an appraisal, dated April 10, 2002, to substantiate the casualty losses which were claimed on the income tax returns. In its brief, the Division has accurately pointed out that there are serious deficiencies in the appraisal report. The appraisal report states that the cost to cure ranges from $18,000.00 to $40,000.00 without showing any basis for the figures. In this vein, the appraiser used $40,000.00 as the cost to cure for 1996 and $25,000.00 for 1997 without any explanation for the particular amounts used. Without any data, this adjustment is unacceptable.

In his appraisal report, the appraiser viewed the flooding as one of external obsolescence because the cause of the problem was external to the subject property and petitioners did not have direct control of the problem. Therefore, in determining the valuation for 1996, he reduced the value of the property by 20 percent or $27,000.00 apparently on the basis of the anticipated market reaction to this type of problem. The appraiser did not factor in the $27,000.00 reduction when estimating the value of the residence immediately before the flood of November 7, 1997. However, he reduced the market value of the residence by the same $27,000.00 after the flood of November 1997. As noted by the Division, logic requires that the $27,000.00 reduction in market value after the 1996 flood would remain when determining the value of the property before the November 1997 flood.

The appraiser also reduced the value of the property by 5 percent, or $6,750.00, during each of the years in issue because of a stigma. The appraiser believed that this adjustment was warranted because, even if it were possible to remedy the flooding problem, a stigma would be attached to the property and the area affected by the flooding.

I. The adjustments premised upon the anticipated market reaction to the flooding, that is, the $27,000.00 for market reaction and $6,700.00 because of the stigma, are also rejected. As noted by the Division, the amount of the loss is limited to physical damage to property (***Squirt Company v. Commissioner***, 51 TC 543, 547, ***affd*** 423 F2d 710; ***Pulvers v. Commissioner***, 48 TC 245, 249, ***affd*** 407 F2d 838). The anticipated market reaction is far too speculative to support a deduction.

J. Under the circumstances presented, the appraisal report is not sufficiently reliable to support a deduction for a casualty loss.

K. Section 162 of the Internal Revenue Code permits an individual to deduct expenses incurred in seeking new employment in the same trade or business if the expenses are directly connected with such trade or business (Rev Rul 75-120, 175-1 CB 55; ***see***, Rev Rul 77-16, 1997-1 CB 37). The expenses are deductible even if new employment is not obtained (***Cremona v. Commissioner***, 58 TC 219; ***see***, Rev Rul 75-120, 175-1 CB 55).

L. Mrs. Temple claimed a deduction for the cost of a subscription to the Times Union as a job search expense. In view of Mrs. Temple's acknowledgment that she looked through the newspaper before she became a nurse, the claim that she read the newspaper mostly for the ads to see what opportunities there were for nurses appears to be a thinly veiled attempt to improperly convert a nondeductible personal expense into a deductible expense.

M. The Division has correctly noted that the mileage expenses claimed by Mr. and Mrs. Temple for job search expenses were not properly documented. Presently, the statutory requirements for proving entitlement to a deduction for an automobile used in travel are strict. Taxpayers are required to keep detailed records substantiating their use of the automobiles for

deductible purposes (IRC § 274[d][4]). Specifically, a log reporting total mileage, business mileage and other personal mileage driven is required (Treas Reg § 1.274-5T). Here, petitioners' documentation does not include the required log. Accordingly, there is no basis to disturb the Division's disallowance of the automobile expenses.

N. The Division disallowed a portion of the deduction claimed for Mrs. Temple's work clothing. In its brief, the Division conceded that as a registered nurse, Mrs. Temple must conform her attire to the employer's dress policy. The Division submits that those items which were disallowed were suitable to general or ordinary wear. With respect to those items which were disallowed, the Division contends that the associated costs, such as mileage to purchase the items, were also properly disallowed.

In response, petitioners submit that the expenses for acquiring and maintaining the uniforms were properly deducted. Petitioners submit that the deductibility of the cost of acquiring and maintaining uniforms is well settled. According to petitioners, the distinctive type of clothing that nurses wear are *per se* deductible. Petitioners ask that judicial notice be taken that distinctive nurses uniforms may be purchased at locations other than Uniform Village and that it is often more economical to purchase uniforms from other vendors. Petitioners also ask that judicial notice be taken "that exposure to such contaminants as HIV AIDS and communicable disease makes such clothing *unsuitable for general or personal wear as a matter of law*." (Petitioners' brief, p. 10; emphasis in original.) Petitioners contend that it is unreasonable to expect a nurse to wear clothing exposed to such contaminants away from work.

O. As a general rule, the cost of clothing is deductible as a business expense if : "(1) the clothing is of a type specifically required as a condition of employment, (2) it is not adaptable to

general usage as ordinary clothing, and (3) it is not so worn." (***Pevsner v. Commissioner***, 628 F2d 467, 469, citing ***Donnelly v. Commissioner***, 262 F2d 411, 412, ***reh denied*** 636 F2d 1106).

P. Initially, it is noted that petitioners' argument that the distinctive nature of nurses uniforms makes them *per se* deductible is without any merit. (***See, Bradley v. Commissioner***, 72 TCM 1001 [which held, among other things, that a nurse was not entitled to a deduction for the cost of uniforms because no evidence was offered as to whether the uniforms could be worn as ordinary clothing.]) With respect to Mrs. Temple's purchases, the clothing which the Division disallowed was adaptable to general usage and therefore properly disallowed. Under these circumstances, the arguments which petitioners are attempting to pursue through judicial notice are irrelevant.

Q. The Division disallowed the deductions claimed by Mr. Temple for safety boots and safety glasses. In its brief, the Division argues that the deductions were properly disallowed because Mr. Temple's explanation was not credible. Specifically, the Division argues that the claim that safety boots could be purchased at a ski shop is not credible. It also submits that the deduction claimed for safety glasses from Sunglass Hut is not credible.

It is not beyond the realm of credibility to believe that work boots could be sold by a ski shop. However, on its face it is dubious for a person residing in New York to choose a ski shop in Vermont as a place to purchase safety boots for work when there are many stores that are closer to petitioners' home. The same may be said of the decision to purchase frames from Sunglass Hut. Compounding the difficulty in accepting this explanation is the fact that there is a clear pattern of attempting to shift nondeductible personal expenses to deductible expenses (e.g., automobile expenses and newspaper subscriptions). Under the circumstances, it is

concluded that petitioners have not sustained their burden of proof of establishing that the Division improperly disallowed the deductions for the safety boots and sunglasses.

R. Similarly, petitioners' claim that certain detergents were used exclusively to clean work clothes is highly implausible. It is not questioned that certain bleaches and detergents were used for this purpose. However, to accept petitioners' position, one would have to accept the proposition that there was no personal use of these items. This strains credulity.

S. The question remains whether petitioners have presented sufficient evidence warranting the abatement of penalties. Tax Law § 685(b)(1) provides that, "If any part of a deficiency is due to negligence or intentional disregard of this article or rules or regulations hereunder (but without intent to defraud), there shall be added to the tax an amount equal to five percent of the deficiency." Here, petitioners have not presented any basis for canceling the penalties which were asserted.

T. The petition of William and Dawn Temple is granted to the extent of Conclusions of Law " F" and "G" and the Division is directed to modify the Notice of Deficiency, dated November 26, 1999, accordingly; except as so granted, the petition is denied and the Notice of Deficiency is sustained.

DATED: Troy, New York
May 8, 2003

/s/ Arthur S. Bray
ADMINISTRATIVE LAW JUDGE